Senate Budget and Fiscal Review—Denise Moreno Ducheny, Chair

SUBCOMMITTEE NO. 4 Agenda

Michael Machado, Chair
Robert Dutton
Christine Kehoe

Hearing Outcomes

Wednesday, April 25, 2007
9:30 a.m.
Room 113

Consultant: Brian Annis

Public Employment and Retirement

Department Budgets Proposed for Consent / Vote Only

(see page 3 for actions)

8385 California Citizens' Compensation Commission

The seven-member California Citizens' Compensation Commission meets annually and is responsible for setting the salaries and benefits for State Legislators, Governor, Attorney General, Lieutenant Governor, Secretary of State, Controller, Treasurer, Superintendent of Public Instruction, Insurance Commissioner, and Board of Equalization members.

The Governor proposes expenditures of $14,000 (all General Fund) and no positions for the Commission – the same amount as 2006-07. The Commission meets annually and is staffed by the Department of Personnel Administration. The Commission budget funds travel expenses and stipends for the annual meeting – Commissioners do not receive a salary.

8320 Public Employment Relations Board

The Public Employment Relations Board (PERB) is responsible for administering and enforcing California's public-sector collective bargaining laws and to assist employers and employees in resolving their labor relations disputes.

The Governor proposes expenditures of $6.2 million (primarily General Fund) and 44.0 positions for the Board – an increase of $508,000 (General Fund) and 3.0 positions. The Administration submitted two Budget Change Proposals for PERB:

1. Staffing for Workload Growth (BCP #1**).** The Governor requests $393,000 (General Fund) and 3.0 legal positions for workload growth primarily measured by the number of annual unfair practice charges. The number of unfair practice charges is expected to increase from an actual of 870 in 2004-05 to 1,359 in 2007-08. PERB indicates that the new positions *may* not be sufficient to fully address the backlog of 150 cases. However, given that this is a General Fund cost, the Board is being conservative in this request, and may return with an additional request next year if the requested positions do, in fact, turn out to be insufficient.

2. Restoration of Funding for Fact Finding Process (BCP #2). The Governor requests a total of $85,000 (General Fund) to restore funding for the daily payments to collective-bargaining "Factfinders." The rate was $600 per day from 1997-98 through 2002-03, but fell to $100 per day due to unallocated budget reductions in 2003-04. The Board then redirected salary savings in 2004-05 and 2005-06 and paid $800 per day. This request would continue funding at the $800 per day level, and support the level of fact finding services actually used in 2005-06. PERB indicates that the same fact finders in the private sector command a fee of $1,400-$2,200 per day for the same service they provide for PERB at the $800/day rate.

Control Section 3.50 Benefit Charges against Salaries and Wages

Control Section 3.50 of the budget bill specifies what benefit expenditures shall be charged against appropriations from which salaries and wages are paid. The language in this control section is identical to language approved with the 2006 Budget Act.

Control Section 4.01 Employee Compensation Savings

Control Section 4.01 provides authority for the Director of Finance to adjust Budget Act appropriations for savings from the Alternative Retirement Program and any budget savings achieved through new collective bargaining agreements. Similar language was included in the 2006 Budget Act.

Control Section 4.11 Establishing New Positions

Control Section 4.11 requires that new positions approved in the budget be established effective July 1, 2007, unless otherwise approved by the Department of Finance. Additionally, it requires the Controller to submit monthly reports to the Department of Finance that lists new positions approved in the budget that will be abolished pursuant to Government Code Section 12439. This control section was first added to the budget in the 2004 Budget Act. Staff understands this control section was added to reduce the practice of departments delaying the establishment of new positions and using the resulting savings for other purposes.

Control Section 4.20
Contribution to Public Employees' Contingency Reserve Fund

Control Section 4.20 sets the employer's contribution to the Public Employees' Contingency Reserve Fund at 0.290 percent of the gross health insurance premiums paid by the employer and employee for administrative expenses. This rate is adjusted annually, as necessary, to maintain a three-month reserve in the fund. The 2006 Budget Act set the rate at 0.270 percent; however, the Administration indicates a rate of 0.290 is needed for 2007-08 to maintain the three-month reserve. The Control Section additionally allows the Director of Finance to adjust the rate, with a 30-day notification to the Legislature, as necessary to ensure a three-month reserve.

Control Section 11.11 Privacy of Information on Pay Stubs

Control Section 11.00 requires that all departments distribute pay warrants and direct deposit advices to employees in a manner that ensures that personal and confidential information is protected from unauthorized access. Identical language was approved with the 2006 Budget Act.

Control Section 29.00 Personnel-Year Estimates

Control Section 29.00 requires the Department of Finance to calculate and publish a listing of total personnel-years and estimated salary savings for each department and agency. These listings must be published at the same time as the publication of: (a) the Governor's Budget; (b) the May Revision; and (c) the Final Change Book. Similar language was approved by the Legislature with the 2006 Budget Act.

Control Section 31.00 Administrative Procedures for Salaries and Wages

Control Section 31.00 specifies Department of Finance oversight responsibilities concerning salaries and wages, and the establishment of positions. The control section also establishes notification requirements for the Administration to report to the Legislature when positions are administratively established and when a position is re-classed to a position with a minimum salary step exceeding $6,506 per month. Similar language was approved by the Legislature with the 2006 Budget Act.

Staff Comment: No issues have been raised with the budgets listed above.

Staff Recommendation: Approve all the consent / vote only budgets and Control Sections.

Action: Approved all consent / vote only issues on a 2-0 vote with Senator Kehoe absent during the vote.

Department Budgets Proposed for Discussion

1880 State Personnel Board

The State Personnel Board (SPB) is responsible for California's civil service system. The SPB provides a variety of recruitment, selection, classification, goal setting, training and consultation services to State departments and local agencies. The Board is composed of five members, who are appointed by the Governor, and serve 10-year terms.

The Governor proposes expenditures of $23.9 million ($5.5 million General Fund) and 161.3 positions – an increase of $1.7 million and 24.7 positions.

The proposed budget included $794,000 (reimbursements) and nine positions to implement SPB's portion of the Financial Information System for California (FI$CAL) information technology project, which would be coordinated by the Department of Finance. On April 11, 2007, the Subcommittee denied the FI$CAL proposal and that action included conforming action to remove the $794,000 and nine positions from the SPB budget – no further action is necessary.

Issues Proposed for Consent / Vote Only

1. **21st Century Project (BCP #7).** The Governor requests $109,000 (reimbursement authority) and a one-year limited-term position for SPB's participation in the State Controller's 21st Century human resources information technology project.
2. **Reimbursable Exam Services to State Departments (BCPs #13 & 14).** The Governor requests a total of $817,000 (reimbursements) and 8.0 positions for the following reimbursable exam services to other State departments: $236,000 and 2.0 positions to administer departmental-specific examinations (BCP #13); and $581,000 and 6.0 positions for test validation and construction (BCP #14).
3. **Bilingual Fluency Examinations (BCP #15).** The Governor requests a total of $96,000 (reimbursements) and 1.0 position for the Bilingual Fluency Testing Program. The SPB currently offers fluency testing in six languages (Spanish, Mandarin, Cantonese, Tagalog, Punjabi, and Vietnamese). With this request, the SPB would work to develop exams for fluency in Arabic, Armenian, Cambodian, Farsi, French, German, Hebrew, Hindi, Ilocano). Government Code Section 7290-7299.8, the Dymally-Alatorre Bilingual Services Act, requires every State agency serving a substantial number of non- or limited-English proficient people to "employ a sufficient number of 'qualified' bilingual staff."

Staff Recommendation: Approve all the consent / vote only issues.

Action: Approved all consent / vote only issues on a 2-1 vote with Senator Dutton voting no.

Discussion / Vote Issues

4. **Centralized Internship Program (BCP #8).** The Governor requests $482,000 (reimbursements) and three positions to begin implementation of a centralized internship program for college students. The program would begin by placing science and engineering students within the California Environmental Protection Agency (CalEPA), but would eventually expand to other student majors and State departments. The Administration indicates that this is motivated by the surge in retirements that the State is expecting over the next five years.

   Staff Comment: Staff understands that CalEPA has withdrawn support for the new program in 2007-08, and that the Administration would support the deletion of this funding for 2007-08. The Administration would continue to study the benefit of a centralized internship program and would return with a revised proposal next year if warranted.

   Staff Recommendation: Reject this proposal.

   Action: Rejected request on a 3-0 vote.

5. **Information Technology (IT) Classification Reform (BCP #1).** The Governor requests $571,000 (General Fund) and four positions to administer the selection phase for the new IT classifications. Last year, the Legislature approved funding of $640,000 in the Department of Personnel Administration's budget to develop an IT classification and reform plan. With this request, the SPB would fund ongoing examination administration, automation, validation and evaluation, maintenance and skills-based certification.

   Background / Detail: In general, the IT reforms involve the consolidation of existing classes, and skills identification, so that an individual's unique mix of IT skills is recognized and hiring departments can better match the job needs with an applicant. The IT classification reform effort was done with union support.

   Staff Comment: The IT classification and examination reform is the first of many job areas that the Administration hopes to modernize. In general, the Administration's approach with IT jobs and the continuing modernization plan is to reduce the number of classifications, expand web-based testing, and centralize testing at the SPB. The goal is to simplify the process for applicants, expand the pool of qualified applicants, and reduce the time it takes to hire a qualified individual. The HR Modernization plan is a discussion issue in the Department of Personnel Administration section of this agenda. The Subcommittee may want to hear testimony on the SPB's role in the HR Modernization proposal.

   Staff Recommendation: Approve this request.

   Action: Approved request on a 3-0 vote.

6. **California Department of Corrections and Rehabilitation (CDCR) Exams (BCP #18).** The Governor requests $231,000 (reimbursements) and 2.0 positions to expedite the exam development and hiring processes for the medical, mental health, and dental classifications at CDCR. The Court Receiver for the *Plata* lawsuit has identified SPB as the focal point to develop automated tests and has indicated support for the two positions to work specifically on CDCR health-related exams.

   Staff Comment: Since CDCR is also under the purview of this Subcommittee, the Subcommittee may want to additionally hear from SPB on the broader range of topics concerning CDCR and the Receiver. Staff understands that the following issues are currently under discussion between SPB and the Receiver:

   - The creation of 250 new CEA positions at CDCR.
   - The creation of a new doctor discipline procedure.
   - Extension of the amount of time employees can be considered temporary.

   Staff Recommendation: Approve the budget request.

   Action: Approved request on a 2-0 vote with Senator Kehoe absent during the vote. The Chair asked the SBP to have further discussions with staff and the LAO so the Legislature has full information concerning the type and scope of the challenges and the secondary impacts both within CDCR and in other State departments.

1920 State Teachers' Retirement System

The State Teachers' Retirement System (STRS) administers retirement and health benefits for more than 735,000 active and retired educators in the public schools from kindergarten through the community college system. Unlike public employees covered under the California Public Employees' Retirement System (PERS), STRS members do not participate in the social security system. According to a June 2005 actuarial analysis, STRS is about 86 percent funded for estimated long-term obligations, leaving an unfunded liability of $20 billion. The LAO indicates that this level of unfunded obligation is about average among large public pension systems.

Proposition 162, approved by voters in 1992, amended the California Constitution to provide the STRS Board with authority over the administration of the retirement system. However, the STRS operations budget is still a Budget Act appropriation which the Legislature adopts. The STRS Board adopted a 2007-08 budget that anticipates benefit and administrative expenditures of $8.5 billion (and 777.2 positions) – up $774 million (and 60.5 positions) from 2006-07. Administration, including services to members and employers, is up about $12 million, and benefit costs are up about $761 million. In the 6300 Budget Item, the Governor is proposing $1.048 billion (General Fund) in State contributions to STRS – up from the $959 million provided in 2006-07. Note: 2006-07 funding included a one-time reduction of $120 million that related to a past accounting adjustment.

The State funds teachers' retirement based on two statutory formulas:

- Benefits Funding – the State's contribution is statutorily based on 2.017 percent of the teachers' salaries. The 2007-08 cost is budgeted at $501 million General Fund.
- Supplemental Benefit Maintenance Account (SBMA) – The State's contribution is fixed by statute at 2.5 percent of teachers' salaries and is intended to provide retiree purchasing power protection. The Governor proposes statutory changes to vest purchasing power protection at 80 percent of initial retirement level, which the Department of Finance believes would result in a State savings of $75 million and a revised contribution of $547 million or 2.2 percent of salaries. (See issue #2 below for additional detail).

(See next page for issues).

Issues for Discussion and Vote:

1. **Risk from Ongoing Litigation (Informational Issue).** As part of the 2003-04 mid-year budget revisions, legislation was enacted (SB 20X, Committee on Budget and Fiscal Review, Chapter 6, St. of 2003) to suspend the Supplemental Benefit Maintenance Account payment on a one-time basis to save the General Fund about $500 million. The STRS Board sued the State claiming Chapter 6 unconstitutionally violated the contractual rights of system members. In May 2005, a Superior Court ruled in favor of STRS, requiring the State to repay the $500 million plus 7 percent interest. The Department of Finance has appealed the ruling arguing that the payment is not constitutionally required, and the California Retired Teachers group has appealed the interest rate calculation, arguing that a 10 percent interest rate should be awarded.

   LAO Recommendation: The Legislative Analyst indicates that an appellate court decision could come in calendar year 2007, and a decision unfavorable to the State could result in a General Fund cost of $650 million to $800 million (depending on the ordered interest payment and the date of the decision). If the court rules in favor of STRS, the LAO recommends that the payment be made from General Fund reserves, or if reserves are insufficient, from low-interest borrowing.

   Staff Recommendation: Informational issues – no action required.

Action: Informational issue – no action taken.

2. **New Purchasing-Power-Protection Vesting & Related Savings (Governor's Budget Trailer Bill).** The proposed budget reduces the Supplemental Benefit Maintenance Account (SBMA) State contribution from 2.5 percent of salary to 2.2 percent – for an annual estimated savings of about $75 million (from reducing this contribution from $622 million to $547 million). The Administration indicates that this contribution level is sufficient to maintain the existing purchasing-power-protection benefit based on a 2005 actuarial analysis. In return, the Administration proposes to vest this purchasing-power-protection benefit at 80-percent of an individual's initial retirement allowance (instead of the current vesting that sets the States contribution at 2.5 percent of salary without a specific level of purchasing-power-protection). Because the funding cut would be tied to a new vested benefit, the Administration argues this proposal is substantially different from the 2003-04 suspension currently under litigation (see issue #1 above).

   Background / Detail: As actuarial analyses are performed over time, the State would have to pay more or less than 2.2 percent of salary – whatever was estimated as necessary to maintain the 80-percent purchasing power protection. However, the proposed trailer bill language cites 2.2 percent specifically instead of the amount needed to maintain the 80-percent benefit – so further statutory change would likely be needed if the contribution level necessary to maintain the new vested benefit changed from 2.2 percent.

   LAO Recommendation: The Legislative Analyst recommends that the Legislature reject the Administration's proposal. The LAO finds there are risks in creating a new vested benefit, because under certain inflation assumptions, this proposal could increase State costs over the long-term (instead of producing the annual savings of about $75 million as the Administration calculates). Additionally, the LAO recommends that any benefit changes be made in concert with a comprehensive plan to address retiree pension and health costs.

   Staff Comment: STRS contracted for an actuarial analysis that estimates the Governor's proposal has a 68 percent chance of saving the State money, and a 32 percent chance of increasing State costs. Inflation rates exceeding 3.5 percent over a period of years would likely trigger State costs instead of savings. The Department of Finance did not have any information on how quickly costs would increase if inflation did exceed 3.5 percent. However, if a high-inflation period, such as that from the 1970's, did reoccur, State costs from this proposal could be in the hundreds of millions if not over a billion dollars annually. It should also be noted that STRS or other interested parties could choose to litigate the proposed change if they believed the new vesting was not a comparable benefit to the current statutory funding of 2.5 percent of salary.

   Staff Recommendation: Keep open for the May Revision.

Action: Held open for May Revision.

Department of Personnel Administration & Related Issues

8380 Department of Personnel Administration

The Department of Personnel Administration (DPA) represents the Governor as the "employer" in all matters concerning State employer-employee relations. The Department is responsible for all issues related to salaries, benefits, position classification, and training. For rank and file employees, these matters are determined through the collective bargaining process and for excluded employees, through a meet and confer process.

The Governor proposes expenditures of $93.6 million ($33.7 million General Fund) and 233 positions for DPA – an increase of $1.8 million and 16.6 positions.

The proposed budget included $1.1 million (reimbursements) and 11.0 positions to implement DPA's portion of the Financial Information System for California (FI$CAL) information technology project, which would be coordinated by the Department of Finance. On April 11, 2007, the Subcommittee denied the FI$CAL proposal and that action included conforming action to remove the $1.1 million and 11.0 positions from the DPA budget – no further action is necessary.

Vote-Only Issues:

1. **Office of Financial Management and Economic Research - Staffing (BCP #2).** The Governor requests $149,000 (General Fund) and 2.0 new positions to address workload associated with salary surveys and fiscal analyses associated with bargaining union contracts and side letters. The DPA indicates that some of this workload results from increased legislative reporting added by SB 621 (Ch 499, St. of 2005, Speier).

   Action: Approved request on a 2-1 vote, with Senator Dutton voting no.

2. **Communications and Electronic Publications Request (BCP#3).** The Department requests 2.0 new positions, to be funded within existing budgeted resources, to staff a communications and electronic publications team to disseminate employee benefit information. The positions would allow DPA to electronically disseminate employee benefit material currently only available by hardcopy. As more material is added to the DPA website, the Department expects printing and postage costs to fall, thus the positions are funded through redirected operating expense funding. A technical change is needed to correctly shift the operating expenses to personnel services (at no net cost) – approval of this issue should include approval of the technical correction.

   Action: Approved request on a 2-1 vote, with Senator Dutton voting no.

3. **Savings Plus Program – Contract Costs (BCP #4).** The Governor requests $726,000 (special fund) to fund increased costs for the Third Party Administrator and external auditors for the Savings Plus Program and the Alternative Retirement Program. Funding for the third-party costs comes from plan participants – either from monthly administrative fees or reimbursements received from the programs' investment providers. A similar request was approved last year; however, DPA indicates program enrollment has exceeded expectations resulting in higher third-party costs.

Action: Approved request on a 2-0 vote, with Senator Kehoe absent during the vote.

4. **Rural Health Care Equity Program Adjustment (April Finance Letter).** The Governor requests a reduction of $2.4 million (General Fund) to adjust Rural Health Care Equity Program (Program) funding to recognize that Blue Shield Health Maintenance Organization established operations in Humboldt County on May 1, 2007. The Program provides subsidy amounts ranging from $500 to $1,500 per year for current and retired State employees who reside in a rural area not served by a health maintenance organization (HMO). Since Humboldt County is now served by an HMO, this budget adjustment is consistent with the statutory provisions of the program.

Staff Recommendation: Approve the consent / vote only budget requests.

Action: Approved request on a 2-0 vote, with Senator Kehoe absent during the vote.

Discussion / Vote Issues

5. **California Department of Corrections and Rehabilitation (CDCR) Workload (BCP #1).** The Governor requests $173,000 (reimbursements) and 2.0 positions to expedite the process of establishing new classes, modifying existing classes, setting up pay differentials, and generally advising executive management on issues related to CDCR lawsuits and secondary adjustment in other departments.

   Staff Comment: Since CDCR is also under the purview of this Subcommittee, the Subcommittee may want to additionally hear from DPA on what efforts they have undertaken and will undertake in the future related to CDCR and the Receiver.

   Staff Recommendation: Approve the budget request.

Action: Approved request on a 2-0 vote with Senator Kehoe absent during the vote. The Chair asked the DPA to have further discussions with staff and the LAO so the Legislature has full information concerning the type and scope of the challenges and the secondary impacts both within CDCR and in other State departments.

6. **Human Resources Modernization Project (April Finance Letter #1).** The Department requests $2.8 million (General Fund), 5.0 new positions, and 70 redirected/loaned positions, to begin development and design for the Human Resources (HR) Modernization Project. Included in this request, is $2.0 million for consultants to develop a Feasibility Study Report (FSR) for a related information technology project, and assist with the design and development of strategies and models. The DPA indicates this proposal is, in part, a response to the Legislative direction last year to develop a comprehensive civil service modernization plan. In addition to the BCP, the Administration has provided committee staff with a document titled, Taking HR to a New Level – Vision for Modernizing California's HR System, dated March 2007, that provides more details on the plan. The Administration indicates this project will include comprehensive reform of the hiring, promotion, and compensation processes of the State, with the goal of expanding the pool of available qualified employees for State jobs. The loaned positions would come from various departments and the project would span seven to eight years.

   Background / Detail: Last year, the Legislature approved funding of $640,000 in the Department of Personnel Administration's budget to develop an information technology (IT) classification and reform plan. The Legislature rejected additional funding of $360,000 for other HR modernization, because the Administration did not have sufficient details on how the funding would be used or a written plan for overall HR modernization. In general, the Administration's approach with IT jobs and the continuing modernization plan is to reduce the number of classifications, expand web-based testing, and centralize testing at the SPB. The goal is to simplify the process for applicants, expand the pool of qualified applicants, and reduce the time it takes to hire a qualified individual. The IT reform effort has union support, and past experience suggests the Administration will need union support for future efforts to be successful.

   DPA indicates that the ongoing new staffing for the life of this project would be constrained to the 5 new positions requested here. Up to 70 existing positions (in DPA and other departments) would be redirected for short-term or long-term assignments related to specific occupation groups or other project tasks. If net new staffing is kept to the 5 positions, the majority of the cost of this proposal would likely be related to the IT project. Since no FSR has been drafted, DPA is unsure of the cost; however, the cost could be sizable.

   Staff Comment: If approved and implemented, the Administration plan would represent a significant change to how state workers are hired, promoted, and compensated. The Subcommittee may want to ask DPA to provide a brief overview of their plan. The LAO has reviewed the plan and will be able to comment.

   Staff Recommendation: Hold this request open for further review and discussion.

Action: Held open. The Chair asked the DPA to work with staff and the LAO to develop a reporting mechanism to keep the Legislature informed about HR Modernization.

7. **"Head Hunter" Services for Medical Classifications (April Finance Letter #2).** The Department requests $1.0 million (two-year limited term General Fund) to hire a recruitment contractor to locate and develop a pool of prospective healthcare professionals to fill State jobs at the California Department of Corrections and Rehabilitation, the Department of Mental Health, the Department of Developmental Services, and the Department of Veterans Affairs.

   Background / Detail: The Finance Letter documents high vacancy rates and extensive use of overtime for medical classifications. Additionally, many departments mitigate vacancies by contracting out for services, which is a more costly option. Therefore, if this request resulted in a sizable net gain in State hires and reduced use of overtime and contract services, it could result in net savings. The concern, however, is that the funding is spent without producing the desired results.

   Staff Comment: The LAO has suggested that options such as performance based contracting be explored and that the funding level be further examined. The Subcommittee may want to hear from both DPA and the LAO on these concerns.

   Staff Recommendation: Keep open for further review.

   Action: Held open. The Chair asked the DPA to work with Staff and the LAO to determine if performance-based contracting would be feasible for this proposal.

8. **Recruitment and Retention Issues (Discussion Issue).** The Subcommittee has heard several recruitment and retention budget issues at hearings over the past month. Among these are a budget request for a pay differential for represented Inspectors at the Board of Pharmacy and a pay differential for non-represented employees at the Department of Finance. The Subcommittee also discussed pay differentials for Investigators with the Medical Board, although the Administration has not presented a budget request for the Medical Board.

   Background / Detail: Various budget subcommittees have expressed concern over several years concerning recruitment and retention, and compaction issues. Last year, for example, extensive time was spent discussing Game Warden pay and high vacancy rates. For that issue, the Administration indicated it would be inappropriate for the Legislature to augment the Department of Fish and Game budget to address the issue, because augmentations of this type should only follow collective bargaining. The Legislature accepted this argument for Game Wardens and augmented the 9800 budget item instead, to provide available funding for Game Wardens or other classifications contingent on the results of collective bargaining. The Legislature has recognized an exception to this practice when it comes to crises situations that result from high vacancies for direct health care providers – for example, funding has been provided for pay increases for medical staff at the Department of Mental Health (DMH), the Department of Developmental Services (DDS), and the Department of Veterans' Affairs (DVA), in advance of collective bargaining.

   Staff Comment: The Subcommittee may want to hear from DPA and the Department of Finance on when it is appropriate to augment the budget for compensation increases in advance of collective bargaining, and what efforts are currently underway to address longstanding recruitment and retention and compaction issues.

   Staff Recommendation: This is a discussion issue – no action is necessary. However, the Subcommittee may want to consider this discussion, when open budget issues, such as the Board of Pharmacy request, are acted upon at future hearings.

Action: Discussion issue – no action taken.

Department of Personnel Administration / State Compensation Insurance Fund – Cross Cutting Issues.

At the March 14, 2007 hearing, the Subcommittee discussed the administration of the workers' compensation system for State employees and the roles of the Department of Personnel Administration (DPA) and the State Compensation Insurance Fund (SCIF) play in providing overall administrative support and oversight for the program. The Subcommittee asked the two departments to provide additional detail and suggest solutions to some oversight gaps raised by a recent Sacramento County District Attorney investigation.

Issues for Discussion

1. **Cost of the Workers' Compensation for State Employees (Informational Issue).** The cost to the State for employees' workers' compensation is displayed in the below table, although actual budget authority is provided in the budgets of individual departments that reimburse SCIF as costs are incurred. The table below shows the change in State workers' compensation costs from the peak in 2003-04 through SCIF estimates for 2007-08.

	2003-04	2004-05	2005-06	2006-07*	2007-08*
SCIF Admin Costs	$53.6	$56.1	$60.7	$68.0	$72.0
Cost of Benefits	$473.6	$439.5	$398.3	$392.1	$383.5
Total State Costs	**$527.2**	**$495.6**	**$459.0**	**$460.1**	**$455.5**
Total New Claims	31,102	25,546	26,095	26,500	27,030

* SCIF estimates

Staff Comment: At the March 14 hearing, the Subcommittee requested additional detail to explain why administrative costs have increased while direct benefit costs have decreased. SCIF provided the Subcommittee additional detail, which is Attachment I at the end of this agenda. The following bullets provide the major reasons for the administrative cost increase:

- While the number of new claims has fallen, the total claims inventory has increased from 33,650 in 2002-03 to 42,400 in 2007-08 (estimate).
- Non-department costs, such as Department of Finance, pro rata, and bank charges have increased from $2.6 million in 2005-06 to $5.8 million in 2007-08 (estimate).
- Staffing caseload was reduced from 184 per adjuster in 2005-06 to about 157 in 2006-07 and 2007-08 (via additional staff). The caseload per adjuster is now similar to the 2002-03 level, and, according to SCIF, similar to that used by private insurers.

Staff Recommendation. Informational issue – no action necessary. The additional information provided by SCIF seems to address the concerns raised by the Subcommittee at the March 14 hearing.

Action: Informational issue – no action taken.

2. **Administration of Workers' Comp for State Agencies (Staff Issue).** The Department of Personnel Administration (DPA) contracts with SCIF (via the "Master Agreement") to provide workers' compensation administrative services to the majority of State departments that are self-insured and to provide insurance coverage to the small number of State departments that are not self insured. Most workers' compensation benefits are paid directly by SCIF (and then SCIF bills departments), but other benefits are paid directly by individual departments. The budget estimates State workers' compensation costs in 2007-08 will be $455 million, with $72 million of that being administrative costs charged by SCIF under the Master Agreement. A recent Sacramento District Attorney's Office investigation of workers' compensation fraud at the California Highway Patrol (CHP) raised questions about the role of SCIF and the role of individual State departments in administering the workers' compensation benefits to State employees (see also the March 14, 2007, Subcommittee agenda for further detail on the CHP).

   Assigned Responsibilities under the Master Agreement. Section III of the Master Agreement lists responsibilities of SCIF, individual State departments, and DPA. Below are some responsibilities that relate to investigating and reducing workers' compensation fraud:

   SCIF Responsibilities:

   07. State Fund shall determine whether an injured employee is entitled to workers' compensation benefits based on the medical record and relevant facts.
   06. State Fund shall notify the Return-to-Work Coordinator (RTWC – a department representative) when there is a need for a comprehensive investigation.

   Individual State Department Responsibilities:

   05. The department RTWC and department employees shall cooperate with the State Fund attorneys and the investigators they assign when the need arises for a claim or fraud investigation.
   14. The RTWC shall report any suspected fraudulent activity to a State Fund's representative of the State Fund office adjusting the claim.

   Department of Personnel Administration Responsibilities:

   01. DPA *may* provide a review, upon request, of the performance of State Fund or a State department with regard to the terms and conditions of this contract.
   02. DPA *may* conduct random annual verifications of compliance of the departments participating in the Master Agreement. These verifications of compliance may include a random sampling, as specified.

   (Note, the DPA indicates it has not conducted a review or verification in at least 6 years. DPA indicates reviews in the past were not deemed productive, and staffing cuts and workload growth have limited the ability of DPA perform this function.)

Sacramento County DA Report. The Sacramento District Attorney (DA) indicated that neither the CHP nor SCIF was living up to their responsibilities under the Master Agreement. In one case, workers' compensation benefits were paid prior to authorization by SCIF. In another case, a SCIF claims manager asked for a personnel file in order to substantiate reports of an internal affairs investigation and the file was not provided nor was any SCIF follow-up noted.

March 14, 2007 Hearing: The Subcommittee asked SCIF and DPA to provide a plan to address the following concerns.

- The Master Agreement does not require SCIF to report the failure of a department to fully cooperate and provide required documentation to SCIF. Therefore, it appears SCIF does not report all issues concerning departmental non-compliance to DPA.
- Departments are required to receive authorization from SCIF prior to submitting requests for Industrial Disability Insurance benefits to the State Controller for payment. The Sacramento DA found that the CHP had submitted requests to the Controller prior to approval by SCIF. There does not appear to be any mechanism in place to monitor or audit this practice (since DPA no longer performs reviews or verification of departments' compliance with the Master Agreement).

DPA Response: In a March 30, 2007 letter, DPA indicates it will take the following actions to respond to the Subcommittee's request:

- DPA and SCIF are drafting language to formalize the process by which SCIF will report departments that fail to provide required information. A contract amendment will be signed, SCIF will report non-compliance to DPA, and the DPA Director will send written directives to the non-compliant departments. If desired, DPA indicates it will report annually regarding the number of referrals and the status of any unresolved referrals (*Committee Staff recommends Supplemental Report Language to implement this report)*.
- DPA will work with the State Controller to add a field to the 21st Century Project human resource IT system which will require a workers' compensation claim number with a new Industrial Disability Leave (IDL) claim. This should prevent improper IDL claims in advance of validation of the workers' compensation claim. In addition, DPA issued a memo to all departments to reinforce that an IDL claim may not be processed to the Controller in advance of SCIF claim approval.
- DPA recommends that if the Legislature desires a resumption of the audit function, it be performed by the Bureau of State Audits (BSA) instead of DPA. (*Committee Staff recommends the Department of Finance's Office of State Audits and Evaluations (OSAE) perform the audit, instead of the BSA – see the staff recommendation below*).

SCIF Response: In e-mails on March 16 and April 5, and subsequent visits to the Capitol, SCIF indicates it will take the following actions to respond to the Subcommittee's request:

- DPA and SCIF are drafting language to formalize the process by which SCIF will report departments that do not comply with the requirements of the Master Agreement.
- The State Contract Services Manager, Frank Floyd, sent a letter to all State Contract Claims Managers on March 16, 2007, requiring them to report any department non-compliance to him immediately, and to conduct appropriate staff training. SCIF provided the PowerPoint training document related to this action.

Staff Comment: Both DPA and SCIF quickly implemented actions to address the Subcommittee's concerns and provided detailed responses. However, two issues are left open for further Subcommittee action:

1. Does the Subcommittee want to add Supplemental Report Language (SRL) requiring DPA to report annually to the Legislature regarding the number and nature of referrals from SCIF on departments' non-compliance with the Master Agreement and the status of any unresolved referrals?
2. Does the Subcommittee want to restore a periodic audit function, placed either at DPA, the Bureau of State Audits, or the Office of State Audits and Evaluations?

Staff Recommendation. <u>Staff recommends</u> that the Subcommittee adopt Supplemental Report Language to require annual reporting from DPA on departments' compliance with the Master Agreement. <u>Staff recommends</u> that the Subcommittee adds budget bill language to one of the departments in its purview – a department that is also a large user of workers' compensation benefits (such as the CHP or Caltrans), to require that the department contract with the Office of State Audits and Evaluations to audit their administration of the workers' compensation system. The cost of the audit would be absorbed within the existing budget of one of these large departments, and the audit would be available for Legislative review next year - at that time, the Subcommittee could consider an audit of a new department in 2008-09, or decide to only implement audits on an ad hoc basis as circumstances warrant.

Action: Adopted staff recommendation on a 3-0 vote. The Subcommittee will take conforming action at a later hearing to add budget bill language to either the Caltrans or CHP budget.

9800 Augmentation for Employee Compensation

This budget item includes funding for pay and benefit increases for those costs that exceed the baseline costs already included in individual department budgets. Generally, this item includes employee compensation funding based upon approved Memoranda of Understanding with the State's 21 bargaining units and funding for health benefit inflation. Also included is compensation increases for excluded employees as is determined by the Department of Personnel Administration or other authorized entities.

The Governor's Budget proposed $972 million ($468 million General Fund). Included in this amount is a funding request of $22.7 million ($20.8 million General Fund) to increase salaries for specified medical classifications at the Department of Developmental Services, the Department of Veterans' Affairs, and the Department of Mental Health, to bring pay in those classifications within 18 percent of the court-ordered salary for the same classifications in the Department of Corrections and Rehabilitation – the court order relates to the *Plata v. Schwarzenegger* lawsuit. Also included is funding of $114 million (General Fund) for correctional peace officer payments resulting from litigation. No funds are set aside to pay for any potential costs related to a new agreement with Bargaining Unit 6, which represents Corrections Officers. Unit 6 is the only unit currently working with an expired contract.

Discussion / Vote Issues:

1. **Update on 9800 Assumptions:** The follow assumptions have changed since January 10, 2007, or may change in the coming months:
   - COLA – the actual Cost of Living Adjustment (COLA) increase to be provided for many bargaining units on July 1, 2007, is 3.4 percent instead of 3.3 percent as estimated in the Governor's Budget. This will increase costs by approximately $10 million ($5 million General Fund).
   - CCPOA lawsuit costs – The State will incur higher compensation costs in 2006-07 and ongoing due to court decision related to a California Correctional Peace Officer Association (CCPOA) lawsuit. A January 19, 2007, Finance Letter added costs above the Governor's budget of $153.5 million in 2006-07, and $46.3 million in 2007-08, both General Fund. The total lawsuit costs through 2007-08 are $439.8 million which is $199.8 million more than assumed in the Governor's budget (all General Fund over 2006-07 and 2007-08).
   - Status of CCPOA bargaining – The CCPOA is the only bargaining unit currently working without a contract, and consistent with the normal practice, no funding is included in the 9800 item in advance of a contract. The LAO indicates each 1 percent salary increase will result in a reduction to the General Fund reserve of $35 million.

   Staff Comment: The Subcommittee may want the Administration to summarize the changes since the Governor's Budget was proposed and preview any further changes that may be coming with the May Revision.

Staff Recommendation: Hold open because further adjustments could come with the May Revision.

Action: Held open for anticipated May Revision changes.

2. **Contingency Funding (Governor's Budget).** The Administration requests a $32 million contingency ($16 million General Fund) in the 9800 budget item for unanticipated costs. The Administration indicates this could cover costs in excess of estimates for current commitments, or funding for new commitments.

   Staff Comment: Last year, the Legislature added funding of $30 million to address non-specified recruitment and retention issues. While this was not specified in the language, the funding was largely a result of concerns with Game Warden pay. The language required a 30-day notification period to the Legislature. The contingency funding requested this year does not tie to any identified recruitment and retention issue (stated or unstated) and a 30-day notification period is not proposed.

   LAO Recommendation: The Legislative Analyst recommends the Subcommittee reject the contingency funding because it may allow the Administration to raise pay for employees without legislative review.

   Staff Recommendation: Reject the contingency funding – consistent with the LAO recommendation. If the Subcommittee later decides to add funds for recruitment and retention (similar to last year's action), that can be done as a separate action.

   Action: Rejected request on a 3-0 vote.

CalPERS–Related Public Employment Issues

1900 Public Employees' Retirement System

The Public Employees' Retirement System (PERS) provides benefits to about one million active and inactive members and about 441,000 retirees. PERS membership is divided approximately in thirds among current and retired employees of the State, schools, and participating public agencies. The Constitution grants the PERS Board "plenary authority and fiduciary responsibility for investments of moneys and administration of the system" as specified. PERS sets the State's retirement and healthcare contribution levels – consistent with union contracts negotiated by the Governor and approved by the Legislature, and vested benefits. This budget item shows PERS benefit and administrative expenditures. State retirement contributions for current employees are built into individual department budgets and Control Section 3.60 (see also the "Control Section 3.60" section later in this agenda). State funding for 2007-08 Health and Dental Benefits for Annuitants is contained in Budget Item 9650 (see also the "9650 Health and Dental Benefits for Annuitants" section later in this agenda). The special authority provided to PERS by the Constitution does not extend to the component of the Health Benefits Program funded from the Public Employees' Contingency Reserve Fund, and, therefore, PERS submits BCPs and Finance Letters to the Legislature for budget changes in those areas.

The PERS Board adopted a 2007-08 budget that anticipates benefit and administrative expenditures of $13.6 billion (and 1,954 positions) – up $1.2 billion (and 1.9 positions) from 2006-07. Administration is relatively unchanged, so this increase is due to increased benefit costs. The State's retirement contribution for current employees is estimated at $2.7 billion (including $1.5 billion General Fund) – an increase of $80 million (including a $44 million General Fund increase) relative to 2006-07. The State's 2007-08 cost for health and dental benefits for annuitants is estimated at $1.1 billion General Fund – an increase of $38 million (note, the General Fund is partially reimbursed by special funds after the budget is enacted). The State's retirement contribution and annuitant health and dental contribution will be re-estimated by PERS around the time of the May Revision and the budgeted amounts will be adjusted at that time.

According to a June 2005 actuarial analysis, PERS is about 83 percent funded for estimated long-term obligations, leaving an unfunded liability of $14.8 billion. These figures are based on the actuarial value of assets methodology that includes some asset smoothing to adjust for short-term fluctuations.

(See next page for issues).

Issues Proposed for Consent / Vote Only

1. **Health Care Decision Support System Innovative Progress Project (BCP #1).** PERS requests $3.3 million in 2007-08 and $3.7 million in 2008-09 from the Public Employees' Contingency Reserve Fund to proceed with a competitive re-procurement for this health care data. This request would continue the practice of PERS contracting with a vendor to collect health-related data feeds from health plans and provide analytical tools to access, manipulate, and report on the data. Most PERS funds are continuously appropriated, but some health-related activities are appropriated in the Budget Act and Budget Change Proposals are submitted by the Department.

2. **Medicare Part B Positions (April Finance Letter #3).** PERS requests a budget augmentation of $659,000 (Contingency Reserve Fund) and 5.0 permanent positions to support on-going activities with the processing of Medicare Part B Income Related Monthly Adjustment Amount reimbursements. Effective January 1, 2007, the Social Security Administration implemented new rules for the calculation of Medicare Part B premiums, which are based on individual annual incomes rather than a flat rate as was done in the past. PERS indicates that the additional 5.0 positions are needed to address workload associated with the program change.

3. **Medicare Part D Positions (April Finance Letter #4).** PERS requests a budget adjustment to shift expenditure of $509,000 for 5.5 positions from the Special Deposit Fund to the Contingency Reserve Fund.

Staff Recommendation: Approve all the consent / vote only budget requests**.**

Action: Approved requests on a 3-0 vote.

Issues for Discussion / Vote

4. **Health Research and Information Systems Cost Avoidance - Positions (April Finance Letter #1).** PERS requests a budget augmentation of $552,000 (Contingency Reserve Fund) and 4.0 permanent positions to support program changes that PERS indicates will result in cost avoidance of over $5 million per year. The new positions would align PERS health information systems with internal and external electronic trading partners to improve transactional efficiencies. Savings are expected through: Kaiser Permanente health premium surcharge reductions; reduction in claims costs paid by the State of California which should be paid by the federal government; system efficiencies; and tighter quality control measures that reduce system issues; and claims retroactivity reduction.

   Staff Comment: PERS estimates this proposal would have a 9:1 benefit to cost ratio – meaning $9 would be saved for every $1 spent. The Subcommittee may want to ask PERS if any realized savings can be accurately tracked. PERS should be prepared to indicate if any further cost-avoidance opportunities exist.

   Staff Recommendation: Approve this request.

Action: Approved request on a 3-0 vote.

5. **May Finance Letter to Update PERS Budget.** Last year, PERS submitted a May Finance Letter to adjust the Budget Bill for those portions of their budget that are solely determined by the PERS Board. The PERS Board usually adopts a final budget in May of each year.

   Staff Recommendation: Keep the CalPERS budget open, pending the CalPERS Board of Administration action in mid-May on the 2007-08 Budget.

Action: Held open for anticipated May Revision changes.

9650 Health and Dental Benefits for Annuitants

This budget item provides funding for health and dental benefit services for more than 210,000 retired state employees and their dependents. The cost split between annuitants and the State is set by Government Code 22871, which establishes a “100/90” formula. Under the formula, the average premiums of the four largest health plans sets the maximum amount the State will contribute to an annuitant’s health benefit. The State contributes 90 percent of this average for the health benefits of each of the retiree’s dependents. The California Public Employees’ Retirement System (PERS) negotiates health care rates with providers and future negotiations will affect the final cost to the State. A revised cost figures should be available in May or June. This funding covers 2007-08 costs and does not provide money to begin pre-funding retirement health costs for current State employees.

Budget Item 9650 includes $1.057 billion ($1.019 billion General Fund) for Health and Dental Benefits for Annuitants – an increase of $38.0 million (note, the General Fund is partially reimbursed by special funds after the budget is enacted for about one-third of these costs). In past years, the funding for this item was based on a forecast of budget-year costs. This year, the proposed budget-year amount is the sum of current-year costs and the Medicare Part D subsidy (see also Medicare Part D discussion below). The Department of Finance also set aside $80 million (General Fund) in an “off budget” expenditure line item titled “Various Departments” to address possible additional retiree health costs beyond those included in the 9650 item.

(See next page for issues).

Discussion / Vote Issues:

1. **Budgeting for Retiree Health (Governor's Budget).** The Administration has budgeted a total of $1.137 billion for retiree health in 2007-08 ($1.057 billion in the 9650 budget item and $80 million in a special set-aside expenditure item). The LAO indicates that this 12 percent budget increase over 2006-07 is less that the 14 percent average increase experienced over the past three years, and is less than the 16 percent average increase experienced over the last seven years. If the actual cost growth for 2007-08 ends up tracking the average increases in recent years, the State might incur costs of $25 million to $50 million above budgeted amounts. Note, the cost increase is not solely driven by health care inflation, but also by growth in the retiree and dependent population.

   Staff Comment: The Subcommittee may want to consider both the appropriate amount to budget for this expenditure and the appropriate mechanism for budgeting. Unlike past years, the Administration has not built a forecast of expenditures into the 9650 item. Instead, the Administration has kept 9560 at the current-year baseline level, added Medicare part-D revenue, and set aside an additional $80 million in a non-designated expenditure item. Staff understands the motivation behind this change is to benefit the State in negotiations with health plans by not indicating the State's estimate of the final cost. If this is deemed desirable, then it may be more appropriate to move the $80 million into the General Fund reserve, as is done for collective bargaining. Secondarily, the total amount budgeted for retiree health is $25 million to $50 million below what recent experience would suggest. The LAO notes that CalPERS could reduce premium costs by increasing co-payments, but the CalPERS Board rejected a co-payment increase in June 2006.

   Staff Recommendation: Hold the budget for this item open for the May Revision. While the Legislature may want to consider changes as to how this is budgeted and the appropriate amount to budget (mindful of its effect on the General Fund reserve), the ultimate cost will be determined by negotiations between CalPERS and health care plans.

   Action: Held open for possible May Revision changes.

2. **Medicare Part D Revenue (Staff Issue):** As indicated on previous pages, the Governor's Budget assumes $38.0 million in federal government reimbursements associated with Medicare Part D, which is the new prescription drug benefit. The Administration proposes that the State continues to receive these reimbursements and that the funds be used to offset the State's retiree healthcare costs.

   Background / Detail: The federal Medicare Modernization Act was signed into law in December 2003 and established Medicare Part D. The Part D benefit is designed to provide Medicare beneficiaries with affordable drug coverage. The federal government created the Part D subsidies to encourage employers, such as the State, to continue offering drug benefits to retirees, instead of shifting enrollees to the Medicare plan. The California Legislature adopted AB 587 (Ch. 527, St. of 2005, Negrete McLeod) which requires CalPERS health program participants who are eligible to participate in Medicare Part D to enroll only in a CalPERS health plan.

   2006 Budget Act - Budget Bill Language: In the spring of 2006, the CalPERS Board considered alternatives to using Part D reimbursements to offset State costs, including using the funding to lower costs for CalPERS enrollees and/or directing the Part D subsidies to the health plans instead of to the State. In response, the Legislature added budget bill language to direct the Part D reimbursements to a special deposit account with the intent that this would retain legislative oversight over the use of the funds. However, CalPERS obtained an opinion from the Attorney General that says the Part D funds should be deposited in the Contingency Reserve Fund (instead of the stand-alone special deposit fund that would segregate the funding until a new appropriation is provided).

   Staff Comment: In past budgets, PERS has been able to provide some General Fund relief while also maintaining existing benefit levels. In 2005, PERS adopted a rate stabilization plan to spread market value asset gains and losses over 15 years instead of 3 years. While that change will be cost neutral over the long term, it did stabilize State costs and resulted in a General Fund savings of $150 million in 2005-06. The Governor's proposal would seem to present PERS with a similar opportunity – to maintain existing benefit levels, while still aiding the General Fund with a $38 million benefit. Staff understands that PERS has concerns with this proposal – the Subcommittee may want to hear from PERS on these issues and ask for any suggestions on how this proposal could be revised to provide the same General Fund benefit, but also mitigate some of their concerns.

   LAO Recommendation: The Legislative Analyst recommends that the Legislature approve the Administration's proposal to use the Part D reimbursements to offset State costs, instead of to increase benefits or costs to state retirees. The LAO indicates this direction is consistent with the intent of both federal and State law. The LAO recommends technical language changes in conformance with this recommendation.

   Staff Recommendation: Hold open for further discussion and review.

   Action: Held open. PERS staff agreed to work with committee staff, the LAO, and the Department of Finance, to see if this proposal can be revised to address their concerns.

3. **New Government Accounting Rules: Pre-funding Retirement Healthcare.** Among other provisions, Governmental Accounting Standards Board Statement 45 (GASB 45) requires government financial reports to quantify the unfunded liabilities associated with retiree health benefits. To be GASB 45 compliant, the State will have to estimate and report unfunded retiree health benefits with financial reports in 2009 that provide account records for the 2007-08 fiscal year. While most state and local governments, including the State of California, have pay-as-you-go retiree healthcare, GASB 45 may lead to a number of states prefunding these benefits.

   Background / Detail: Last year, the Legislative Analyst estimated the State liability may be in the range of $40 billion to $70 billion; and the annual cost to fully pre-fund this benefit, over 30 years, may be in the range of $6 billion. No money is proposed for pre-funding health benefits in 2007-08; however, Executive Order S-25-06 signed on December 28, 2006, created the Public Employee Post-Employment Benefits Commission to examine unfunded retirement benefits. This Commission is charged with delivering a plan by January 1, 2008, that would include a proposal to address the government's unfunded retiree health and pension obligations.

   The 2006 Budget Act included $252,000 for the State Controller to contract with actuaries to produce the State's first retiree health liability valuation, consistent the new accounting rules. That valuation is expected to be released in calendar year 2007 – perhaps as early as May.

   LAO Recommendation: The Legislative Analyst recommends that the Legislature: (1) begins to set aside money to address state retiree health liabilities, and (2) require improved disclosure of these liabilities by local governments, including school districts.

   Staff Comment: The Subcommittee may wish to ask the LAO to summarize their report and recommendations and ask the Administration to respond.

   Staff Recommendation: Keep the 9650 Budget Item open – revised cost figures may be available with the May Revision of the Governor's Budget.

   Action: Informational issue, no action taken.

Control Section 3.60 Contributions to Public Employees' Retirement Benefits

Control Section 3.60 of the budget bill specifies the contribution rates for the various retirement classes of State employees in the California Public Employees' Retirement System (CalPERS). This section also authorizes the Department of Finance to adjust any appropriation in the budget bill as required to conform to changes in these rates.

The State's contributions to CalPERS in 2007-08 are currently estimated at $2.8 billion ($1.5 billion General Fund) – an increase of $80 million over 2006-07 (including a $44 million General Fund increase). The following table provides proposed rates with historical comparisons, and is copied from the LAO's *Analysis of the 2007-08 Budget Bill*.

Figure 1

State Retirement Contribution Rates

1991-92 Through 2007-08 (As Percent of Payroll)

Fiscal Year	Misc. Tier 1	Misc. Tier 2	Industrial	Safety	Peace Officer/ Firefighter	Highway Patrol
1991-92	11.80%	4.00%	13.40%	17.40%	17.40%	21.70%
1992-93	10.3	3.4	12	15.7	15.6	17.1
1993-94	9.9	5	11.8	15.5	15.2	16.9
1994-95	9.9	5.9	10.6	13.9	12.8	15.6
1995-96	12.4	8.3	9	14.2	14.4	14.8
1996-97	13.1	9.3	9.3	14.7	15.4	15.9
1997-98	12.7	9.8	9	13.8	15.3	15.5
1998-99	8.5	6.4	4.6	9.4	9.6	13.5
1999-00	1.5	—	—	7.5	—	17.3
2000-01	—	—	—	6.8	2.7	13.7
2001-02	4.2	—	0.4	12.9	9.6	16.9
2002-03	7.4	2.8	2.9	17.1	13.9	23.1
2003-04	14.8	10.3	11.1	21.9	20.3	32.7
2004-05	17	13.2	16.4	20.8	23.8	33.4
2005-06	15.9	15.9	17.1	19	23.6	26.4
2006-07	17	16.8	17.9	19.3	24.5	31.5
2007-08a	16.8	16.5	17.7	19.1	25.6	31.1

California Public Employees Retirement System estimates

Staff Comment: The above rates show significant annual fluctuations, which is primarily based on the investment market. The rates in 2005-06 through 2007-08 reflect CalPERS' new rate stabilization policy, which builds gains and losses in the value of assets into the actuarial calculation of the plans' asset value, over 15 years, instead of the three years of the prior policy. While the rates generally fall slightly in 2007-08, due to investment growth (investments grew about 12 percent in 2005-06, compared to the system's normal projected investment return of under 8 percent annually), the overall State contribution rises by $80 million primarily because of payroll growth. The LAO notes that the Peace Officer and Firefighter (POFF) group rate increase is due to the enhanced "3 percent at 50" retirement benefit that took effect for correctional officers and firefighters on January 1, 2006, and is reflected in the rates for the first time in 2007-08. The POFF contribution for 2007-08 is expected to total $755 million (General Fund), which is about half of the total General Fund retirement cost.

Issues for Discussion:

1. **PERS Revision of 2007-08 Retirement Contribution Rates.** As was indicated in the CalPERS section of this agenda, Proposition 162, approved by voters in 1992, amended the California Constitution to provide the PERS Board of Administration with authority over the administration of the retirement system and set contribution rates. The CalPERS Board is expected to adopt new rates at the May 16, 2007, meeting. The budget will then be adjusted to reflect the new rates and costs.

   Staff Comment: The Administration expects to submit a May Finance Letter to reflect the adjusted rates.

   Staff Recommendation: This is an informational issue – no action is needed.

   Action: Held open for anticipated May Revision changes.

2. **Pension Obligation Bonds.** The Governor's Budget assumes that pension obligation bonds (POBs) will be sold in 2007-08, yielding $525 million in General Fund revenues.

   Background / Detail: In 2004, the Legislature enacted a law authorizing the sale of up to $2 billion in POBs to fund the State's CalPERS obligation. Litigation has delayed the issuance of bonds and the Administration has reduced the assumed bond proceeds: the 2005 Budget Act assumed bond proceeds of $525 million from a 2005-06 issuance; the 2006 Budget Act assumed no bond sales would occur in either 2005-06 or 2006-07, but assumed a bond issuance in 2007-08 in the long-term budget assumptions. A 2007-08 bond issuance totaling $525 million is included in this year's Governor's Budget for 2007-08. The Administration is currently appealing a November 2005 Sacramento Superior Court decision that found the bonds unconstitutional. The practical effect of a delay in bond issuance beyond 2007-08 is a reduction to the General Fund reserve of $525 million.

   Staff Recommendation: The Subcommittee may want to hear testimony from the Department of Finance and the LAO on the issue of building $525 million in Pension Obligation Bond revenue into the 2007-08 budget.

   Staff Recommendation: Hold this item open pending the May Revision forecast.

   Action: Discussion issue – no action taken.

Attachment I – Administrative Cost of Workers' Compensation for State Employees

MASTER AGREEMENT BUDGET COMPARISON
FISCAL YEARS 2005/2006 - 2007 / 2008

FISCAL YEAR	PROGRAM COMPONENT	AMOUNT	
2007/2008	• Direct Claims & Legal Costs and Operational Expenses	$58,275,000	
	• Support Staff Departments (Corporate Legal, Information Technology, Human Resources, etc.)	$7,940,000	
	• Non-Departmental Costs (Department of Finance, Pro Rata Fees & Bank Charges)	$5,785,000	
			$72,000,000
2006/2007	• Direct Claims & Legal Costs and Operational Expenses	$56,500,000	
	• Support Staff Departments (Corporate Legal, Information Technology, Human Resources, etc.)	$7,625,000	
	• Non-Departmental Costs (Department of Finance, Pro Rata Fees & Bank Charges)	$3,875,000	
			$68,000,000
2005/2006	• Direct Claims & Legal Costs and Operational Expenses	$50,740,000	
	• Support Staff Departments (Corporate Legal, Information Technology, Human Resources, etc.)	$7,400,000	
	• Non-Departmental Costs (Department of Finance, Pro Rata Fees & Bank Charges)	$2,555,000	
			$60,695,000

FISCAL YEAR	DISABILITY INVENTORY	ADJUSTER STAFFING	AVERAGE CASELOAD	LEGAL INVENTORY	LEGAL STAFFING	AVERAGE LEGAL CASELOAD	SERVICE FEE
2007/2008	**42,400 (Est.)**	**268**	**158**	**12,725 (Est.)**	**68**	**187**	**72,000,000**
2006/2007	**42,214**	**268**	**157**	**12,569**	**68**	**185**	**68,000,000**
2005/2006	**42,115**	**229**	**184**	**11,923**	**62**	**192**	**60,694,499**
2004/2005	**41,014**	**226**	**181**	**12,631**	**61**	**207**	**56,108,906**
2003/2004	**36,606**	**214**	**171**	**11,892**	**63**	**189**	**53,605,978**
2002/2003	**33,650**	**218**	**154**	**10,080**	**62**	**175**	**53,106,805**

The increase in Service Fees the last two years is due to higher staffing levels; General Salary Adjustments for staff in 2006 (3.5%) with the impact being felt this year; cost of living adjustments scheduled for July 2007; State Pro Rata fees assessed by the Department of Finance (covering centralized services provided by Departments such as Finance, State Controller, State Personnel Board, Legislature, etc). Presently, ERF/OASDI and Employee Health Insurance contributions amount to 40.4% of payroll. Salaries and benefits presently account for 82.6% of our direct costs for claims, legal, and staff support services.